

MOODY'S

INVESTORS SERVICE

New Issue: Moody's assigns Aa1 to Energy Northwest (WA) Project 1 and Project 3 revenue bonds and affirms Bonneville Power Administration, OR's Aa1 issuer rating. Rating outlook is stable

Global Credit Research - 29 Jul 2014

Approximately \$6.8 billion of debt affected

BONNEVILLE POWER ADMINISTRATION, OR
Electric Generation
OR

Moody's Rating

ISSUE	RATING
Project 3 Electric Revenue Refunding Bonds, Series 2014-C	Aa1
Sale Amount	\$72,400,000
Expected Sale Date	08/06/14
Rating Description	Revenue: Government Enterprise

Project 1 Electric Revenue Refunding Bonds, Series 2014-C	Aa1
Sale Amount	\$200,000,000
Expected Sale Date	08/06/14
Rating Description	Revenue: Government Enterprise

Moody's Outlook STA

Opinion

NEW YORK, July 29, 2014 --Moody's Investors Service has assigned a Aa1 rating to Energy Northwest WA Project 1's (Project 1) \$200 million of Project 1 Electric Revenue Refunding Bonds, Series 2014-C and Energy Northwest WA Project 3's (Project 3) \$72.4 million of Project 3 Electric Revenue Refunding Bonds, Series 2014-C. Moody's also affirmed the existing Aa1 rating on Project 1 & 3, Energy NW, WA - Proj. 2 (Columbia Gen. Sta.) (CGS), and Bonneville Power Administration, OR's (BPA) Aa1. The rating outlooks are stable for all four issuers.

Summary Rating Rationale

The Aa1 rating on Energy Northwest's (ENW) CGS, Project 1, and Project 3's revenue bonds reflect BPA's contractual obligation to pay including debt service under each respective net billing agreement, BPA's long history of meeting its contractual obligations, and BPA's Aa1 issuer rating. We view these strengths as sufficiently mitigating the additional Project 1 & 3 credit risk tied to the debt extension past the originally expected commercial operational end dates of 2020 and 2021, respectively. In exchange for extending the Project 1 & 3 debt, BPA will accelerate repayment of higher interest US federal appropriations debt to save on total interest costs. BPA estimates \$790 million of interest savings between now and 2028 assuming debt extensions for all of ENW's nuclear projects and a corresponding accelerated federal debt repayment. While this financial engineering will likely be beneficial for BPA's customers, BPA's federal debt reduction over time in exchange for greater non-federal debt, weakens the de-facto seniority benefit of BPA's non-federal debt. However, BPA's rating remains unaffected at this time given the uncertainties of BPA's long-term capital structure.

The affirmation of BPA's Aa1 issuer rating reflects its fundamental credit strengths comprising of US Government (Aaa stable) support features, strong underlying hydro and transmission assets, competitive power costs, and power supply contracts with customers through 2028. Explicit US Government support features include a \$7.7 billion borrowing authority with the US Treasury and the legal ability to defer its annual US Treasury repayment if

necessary. BPA's importance to the US Northwest region and its role as a US government agency represent drivers of implicit support. The implicit and explicit support features represents the key drivers between BPA's Aa1 rating and the Aa2 indicated rating under the US Public Power with Generation Ownership methodology.

BPA's rating also considers long-term credit challenges such as hydrology and wholesale market price risk, environmental burdens, high debt load, lengthy ratemaking process, declining liquidity, and low financial metrics. Hydrology and wholesale market prices are the greatest volatility drivers of BPA's financial performance with an almost \$1 billion swing in net revenues between the best and most challenging years since 2000. The current year's above average regional hydrology conditions are expected to result in a modest increase in reserves for FY 2014 although BPA's longer term of declining internal liquidity remains an ongoing challenge.

BPA's Strengths

- U.S. government support through US Treasury borrowing line and federal debt service deferral ability
- Regional importance as indirect power provider for 12 million people
- Access to 22 GW of low cost, federally owned hydro system
- Dominant electric transmission provider in the Pacific Northwest
- Highly competitive rates
- Long term power sales contracts with creditworthy public power entities

BPA's Challenges

- Long and complex ratemaking process
- Significant exposure to hydrology risk and wholesale power markets
- Low consolidated credit metrics and trend of declining reserves
- Large debt funded capital program
- Sizeable debt burden of Energy Northwest's nuclear projects
- Significant fish and wildlife environmental costs

Outlook

BPA stable outlook considers BPA's FY 2014-15 rates, BPA's near-term ability to withstand difficult market price and hydrology conditions, and BPA's plan to maintain sizeable availability under the US Treasury line. The stable outlook on ENW's CGS, Project 1, Project 3 and other BPA supported obligations reflect BPA's stable outlook.

WHAT COULD MAKE THE RATING GO UP

BPA's rating could improve over the long term if BPA is able to fully mitigate hydrology and wholesale price risk and if BPA implements policies to ensure strong internal risk reserves resulting in at least 250 days cash on hand on a sustained basis. Ratings on BPA supported revenue bonds could be upgraded if BPA is upgraded.

WHAT COULD MAKE THE RATING GO DOWN

BPA's rating could be negatively pressured if BPA's internal liquidity drops below 30 days cash on hand on a sustained basis, if US Government support diminishes, federal constraints are placed on BPA or if the US Government's rating is lowered below Aa1. Additionally, ratings on BPA supported revenue bonds including CGS, Project 1, and Project 3 debt could be downgraded if BPA is downgraded or if the underlying contracts (e.g. net billing agreements) are violated.

DETAILED CREDIT CONSIDERATIONS

BPA was created in 1937 by an act of the US Congress and is one of four regional power marketing agencies within the US Department of Energy. BPA is primarily responsible for federally owned generation and electric transmission assets in the Pacific Northwest spanning all or parts of eight states. The federal hydro projects serve numerous purposes, including irrigation, navigation, recreation, municipal and industrial water supply, fish and

wildlife protection, and power generation. The Army Corps of Engineers and the Bureau of Reclamation operate the hydro projects. Many of the statutory authorities of BPA are vested with the Secretary of Energy, who appoints and acts through the BPA administrator.

BPA operations are divided between Power Services and Transmission Services though all cash flows ultimately flow into one account (BPA Fund) at the US Treasury. The Power Services business is responsible for the revenue and costs of BPA's generation resources and represents the largest segment at 75% of BPA's revenues in FY 2013. Transmission Services is responsible for the revenue and costs of BPA's electric transmission system and generates the remainder of BPA's revenues. BPA's power rates are reviewed and approved by the Federal Energy Regulatory Commission (FERC) according to the Northwest Power Act.

USE OF PROCEEDS: Bond proceeds will be used to repay bank loans at Project 1 & 3. Project 1 & 3 used the bank loans to make the July 1, 2014 bond payments and this bond financing effectively extends that payment to 2025 to 2028.

LEGAL SECURITY: CGS, Project 1, and Project 3's bonds are secured by a pledge of specific project revenues primarily sourced under the tri-party net billing agreements with BPA and project participants. The Project 1's pledge is subordinate to \$41.1 million of prior lien bonds. The Project 3's pledge is subordinate to \$136.9 million of prior lien bonds. The net billing agreements obligate the project participants, consisting of numerous municipal and cooperative electric utilities, to pay ENW their proportionate share of the project's annual costs, including debt service, irrespective of whether the project is operable or terminated. BPA, in turn, is obligated to pay (or credit) the participants identical amounts by reducing the amounts the participants owe for power and service purchased from BPA under their power-sales agreements. BPA has also agreed, in the event of any insufficient payment by a participant, to pay the amount due in cash directly to the project. In 2007, Energy Northwest and BPA adopted a new direct pay agreement whereby Energy Northwest participants directly pay all costs to BPA rather than through Energy Northwest. BPA has made a clear and tested commitment to support the payment under the net billing through more than more than 30 years of stressful circumstances including legal challenges in the early 1980s. The obligation of BPA and the participants remain in force. There is no debt service reserve. For legal security of other rated BPA supported debt, please see Appendix 2 of 'Bonneville Power Administration: On the Hunt for New Capital Sources' credit focus report for description.

INTEREST RATE DERIVATIVES: BPA's lease debt has approximately \$950 million of notional interest rate swaps. We understand there are no collateral posting requirements under any conditions.

For description of the BPA's key rating drivers, please see Moody's new issue report dated March 27, 2014.

KEY STATISTICS

Aggregate BPA Power Capacity, 2013 Operating Year at median water conditions: 10,585 average megawatts

Non-Federal Debt Service Coverage Ratio, 2013 (reported): 2.2 times

Non-Federal Debt Service Coverage Ratio, 2013 (Moody's): 1.73 times

Total Debt Service Coverage Ratio, 2013 (Moody's): 1.06 times

Available BPA Reserves, 2013 (encumbered and unencumbered): \$ 1.27 billion

Total Reserves Available for Risk, 2013: \$641 million

BPA Payment to U.S. Treasury, 2013: \$692 million

Authorized Line of Credit With U.S. Treasury, 2013: \$7.7 billion (\$3.8 billion available)

BPA Average Tier 1 Rate, 2014: \$31.50/MWh

Columbia Generating Station Nameplate Capacity: 1,130 MW

Non-federal debt, FY 2013: \$6.8 billion

Federal debt, FY 2013: \$8.2 billion

BPA Public Power Rating Methodology Factors (Consolidated)

1. Cost Recovery Framework (25% weight): (Aa)
2. Willingness to Recover Costs and Maintain Sound Financial Metrics (25% weight): (A)
3. Management of Generation Risk (10% weight): (Aa)
4. Rate Competitiveness (10% weight): (Aa)
5. Financial Strength:
 - Sub factor a) Adjusted Days Liquidity on Hand (10% weight): (131) (A)
 - Sub factor b) Debt Ratio (10% weight): (98%) (Baa)
 - Sub factor c) Adjusted Debt Service Coverage (10% weight): (1.08x) (Ba)

Grid Indicated Rating: A2

Notching:

Lack of debt service reserve: -0.5

Other: +3 (regional importance, borrowing line, deferral ability)

Scorecard Indicated Rating: Aa2

ENW CGS JAA TAKE OR PAY METHODOLOGY FACTORS:

- 1 Participant Credit Quality and Cost Recovery Mechanism (45%): Aa1
2. Asset Quality (15% weight) Baa (baseline factor)
3. Competitiveness (15% weight): Baa (baseline factor)
4. Financial Strength:
 - Sub factor a) Adjusted Days Liquidity on Hand: (10%weight): Baa (baseline factor)
 - Sub factor b) Debt Ratio: (10% weight): Baa (baseline factor)
 - Sub factor c) Debt Service Coverage Ratio: (10% weight): Baa (baseline factor)

Grid Indicated Rating: Aa1

Notching: None

Scorecard Indicated Rating: Aa1

ENW PROJECT 1 & 3 JAA TAKE OR PAY METHODOLOGY FACTORS:

- 1 Participant Credit Quality and Cost Recovery Mechanism (45%): Aa1
2. Asset Quality (15% weight) B (baseline factor)
3. Competitiveness (15% weight): B (baseline factor)
4. Financial Strength:
 - Sub factor a) Adjusted Days Liquidity on Hand: (10%weight): Baa (baseline factor)
 - Sub factor b) Debt Ratio: (10% weight): B (baseline factor)
 - Sub factor c) Debt Service Coverage Ratio: (10% weight): Baa (baseline factor)

Grid Indicated Rating: A3

Notching:

Scorecard Indicated Rating: A3

The principal methodology used in this rating was U.S. Public Power Electric Utilities with Generation Ownership Exposure published in November 2011. An additional methodology used in this rating was US Municipal Joint Action Agencies published in October 2012. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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